No. 3913

In The

United States Circuit Court of Appeals

For the Ninth Circuit

In the Matter of C. F. MASON and WM. McD. OWEN, co-partners, trading as MASON & OWEN,

Bankrupts,

C. F. MASON and WM. McD. OWEN,

Bankrupts,

GEORGE P. KIER, Trustee,

Appellant,

vs.

JOSEPH F. BURCH, JR.,

Appellee.

Appellant's Brief

Upon Appeal from the United States District Court for the Southern District of California, Southern Division

WILL J. THAYER,
1530 Spreckels Building, San Diego, California
Appellant's Attorney.

FILED

FRYE & SMITH, PRINTERS, SAN DIEGO, CAL.

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

In the Matter of C. F. MASON and WM. McD. OWEN, co-partners, trading as MASON & OWEN,

Bankrupts,

C. F. MASON and WM. McD. OWEN,

Bankrupts,

GEORGE P. KIER, Trustee,

Appellant,

vs.

JOSEPH F. BURCH, JR.,

Appellee.

Appellant's Brief

This is a reclamation proceeding in bankruptcy begun by the petitioner to recover from the trustee in bankruptcy 300 shares of stock of the Ray Consol. Copper Company. From an order in petitioner's favor awarding him possession of the stock the trustee in bankruptcy appeals.

STATEMENT OF THE CASE.

On November 3, 1920, petitioner was the owner of three certificates of stock of the above named company,

representing 300 shares, and on that date delivered them, endorsed in blank, to Mason & Owen, stockbrokers, and at the same time gave them written authority to pledge the shares for any sum that they saw fit.

Mason & Owen immediately pledged the shares to Logan & Bryan to secure their general indebtedness. The shares reached Logan & Bryan on November 9, 1920, at which time said indebtedness amounted to $330,778.87, but was subsequently reduced so that at the time of bankruptcy the amount was $208,338.09. (Record, p. 7.)

In addition to pledging petitioner's stock Mason & Owen also pledged to Logan & Bryan a large number of shares of stock belonging to their other customers and it was stipulated as one of the facts in this case that, *"all of the said stock was held by Logan & Bryan as security for the payment of the said indebtedness to them of the said Mason & Owen."* (See Stipulation, Record, p. 8.)

The value of all of the pledged stocks held by Logan & Bryan was $339,156.00 (Record, p. 8) and the value of petitioner's stock was $3,375.00 (Record, p. 17).

The written authority given by petitioner to Mason & Owen to pledge his stock will be found on p. 10 of the Record, the relevant portion of it being as follows:

> "That all securities * * * now or hereafter carried in my account * * * may be * * * pledged by you either separately or together with other securities belonging to others, either for the sum due thereon, or for a greater sum."

The word account is defined in *Frutig* vs. *Trafton*, 2

Cal. App., 47 (49) and it is plain that petitioner's shares were carried in his account with Mason & Owen. (See exhibits on pp. 9, 11 and 12 of the Record) so that the authority to pledge clearly covered the shares in question.

After bankruptcy proceedings were begun and on December 8, 1920, a sale of a portion of the stocks belonging to Mason & Owen's customers was made which sale produced enough money to pay Logan & Bryan in full, leaving a number of shares unsold, among them being those belonging to the petitioner. (Record, pp. 8 and 18.)

The stocks first sold were those which had been purchased by margin customers and the petitioner claims that his stock should now be delivered to him free and clear and that the owners of the other stocks should stand the entire expense of paying off the indebtedness of Mason & Owen to Logan & Bryan, notwithstanding the fact that he consented to the pledge of his shares to secure that indebtedness.

POINTS AND AUTHORITIES.

The argument naturally divides itself into two parts:

1st. Did the written authority executed by petitioner authorize the pledging of his stock.

2nd. If it did, then must he contribute to paying off Logan & Bryan's lien.

THE WRITTEN AUTHORITY CONFERRED POWER TO PLEDGE THE STOCK.

The written authority (Record, p. 10) in paragraph second thereof gave the right to do two things, viz., (a) to *pledge* the stocks referred to or (b) to *sell* same.

The power to *sell* was coupled with certain conditions and could be exercised only in the event that the marginal protection became impaired. The power to sell was not exercised and need not be considered further.

The power to *pledge,* however, unlike the power to sell, was *unconditional. It was not limited in any manner or by any words whatever.* Mason & Owen were simply given unlimited authority to pledge petitioner's stocks "either for the amount due thereon or for a greater sum." Mason & Owen had a broker's lien on the stocks for all advances made by them on petitioner's account.

9 Corpus Juris, p. 665.

The only amount actually due to them from petitioner was $1.26 for insurance on the stock to New York (Record, p. 11, Exhibit C), but the written authority is very explicit in giving Mason & Owen power to pledge the stock "for a greater sum". (Record, p. 10.)

We submit, therefore, on this branch of the case that petitioner did consent to the pledging of his stock and the stock *was* pledged. Being a valid pledge for a valid indebtedness the petitioner cannot recover the pledged stock without paying, or offering to pay, the indebtedness for which it was pledged.

The petitioner manifestly could not have recovered his stock from Logan & Bryan before the indebtedness due to Logan & Bryan had been paid off.

That, we presume, will be conceded.

The only theory then, on which petitioner can recover is that he had the right to require the stocks of the other customers of Mason & Owen to be sold in order to save

him harmless, and that contention presents the principal question in this case.

Before discussing that theory we wish to propound this query to appellee: If an action had been begun before the sale by all the customers for the purpose of redeeming the pledged stocks from Logan & Bryan's lien, would not all stocks which were pledged with the consent of the owners thereof have been obliged to bear their proportionate part of the payment to Logan & Bryan?

The above question must necessarily be answered in the affirmative.

This being so, the next question is whether the petitioner is in any better position by reason of the facts that the sale was made after bankruptcy and that it was not necessary to sell all of the stocks in order to pay off the pledgee and that some of the stocks fortuitously survived the sale.

AFTER INSOLVENCY ALL STOCKS UNDER PLEDGE MUST CONTRIBUTE RATABLY.

We contend that *after* bankruptcy occurs all stocks pledged for a common debt must contribute ratably, and that no preference will be given any particular stock because of the fact that the stocks first sold produced enough money to discharge the entire indebtedness.

This identical question was before the court in *Re Wilson,* 252 Fed., 631 (639), where it was said of a similar case:

> "It is true that the court held that the admiralty principle of general average was not applicable, and that the pledge should not be treated as a common

adventure; but it did not disturb the proposition that it is the character of the equity which determines how any particular claim shall be classified. The case is quite different from one where a pledgee rightly sells collateral *prior* to a bankruptcy. In the absence of fraud or collusive arrangements, the result of such a sale is one of the hazards which may befall persons in a business of this character. If, however, it be held that, *after a petition in bankruptcy has been filed,* the pledgee, by selecting for sale some stocks and not others, can thereby save some stocks intact for the owners without the burden of contribution, and not others, it can readily be seen that the door will be opened for the most indefensible kind of favoritism, and possibly for corrupt bargains between the owners of securities and the pledgee. Indeed, a pledgee of his own motion, without any agreement with owners of securities, could easily safeguard his friends to the detriment of others who were strangers to him."

(Our italics.)

In *Whitlock* vs. *Seaboard Nat'l Bank,* 60 N. Y. Supp., 611, it appeared that a broker had pledged customers' securities and the pledgee sold sufficient thereof to satisfy its claim, leaving three securities unsold, and the question arose whether the unsold securities must contribute to the removal of the burden of the loan, and the court said:

"As these several owners, though dealing with Cuthbert separately, became involuntarily involved in common in the payment of his indebtedness to the bank by the burden laid upon their several securities for one common debt, their separate relations as against Cuthbert, (the broker) became changed into a *common co-suretyship* for him with the bank to the extent, relatively that their property was forced to pay his obligations. What, then

are the several rights of those entitled to the balance left? As against Cuthbert, and the bank itself, when satisfied, each owner has the right to follow his property, and appropriate any specific items left on hand as his own, and, if converted into money, has the right to the proceeds of that property. *As to his co-sufferers, however, a different rule prevails.* Equitable considerations govern the relations of sureties toward their co-sureties, as well as towards the principal debtor and creditor. The securities here first sold were the vanguard of the contest, and bore the brunt of the advance sacrifice, thus shielding the other stocks and any balance of money left after the sale. *The rights of the sureties as between themselves were fixed by the insolvency of the broker* and the necessity of a sale to free the whole of the property from the unwarranted act of the person to whom it was first pledged. *Those rights could not be changed or determined by any hazard of chance in the order of sale, or by any selection of the pledgee bank.* The right of redemption existed to relieve that burden, and, if all the sureties had united for that purpose, so that the bank was obliged to accept the full sum tendered, the several contributions would have been rated proportionately to the extent of the loss or injury." (Our italics.)

In a recent case (*Unangst* vs. *Roe*, 177 N. Y. Supp., 706 (712) the court said on this same point:

"The rights of the parties between themselves *became fixed when the brokers made their assignment and the trust company was compelled to resort to the collateral deposited as security.* All of that collateral was subject to the same obligation and lien, and its owners as co-sureties were entitled then to contribution from each other for any loss sustained. *Their rights could not be changed or determined by any hazard of chance in the order of sale* or by any selection of the pledgee bank. It

> follows that the defendant could gain no advantage by the delivery of the stock to him and must account for its value to his co-sureties." (Our italics.)

We therefore submit on this branch of the case that the court should not show any favoritism by picking out the stock of any particular owner and directing it either to be sacrificed or saved, but that *equal treatment will be accorded all the owners.*

We submit, then, that the petitioner stands just as though all of the parties whose stocks were in the pledge had joined, or been joined, in an action to redeem the stocks from the pledgee, in which event equal treatment would have been accorded to them all.

The petitioner particularly cannot claim that he was aggrieved by the pledge of his stock because he *specially authorized the pledge to be made.* His case is fully covered by Sec. 3515 of the Civil Code declaring that,—

> "He who consents to an act is not wronged by it."

Whatever was done with his stock was done with his *consent* and surely he is in no position to demand that the other customers of Mason & Owen are obligated to shield him from the consequences of his own act.

It may be contended, however, that petitioner's equity is superior to those of his co-sureties because the latter had made marginal purchases.

We will notice that point briefly.

THE RIGHTS OF THE MARGIN CUSTOMERS ARE NOT INFERIOR TO THE RIGHTS OF THOSE WHO CONSENTED TO THE PLEDGE OF THEIR STOCKS.

The stipulation admits that these margin stocks be-

longed to Mason & Owen's customers (Record, 17-18) and we must therefore assume one of two things, viz., either that (a) the margin stocks were pledged rightfully or (b) that they were pledged wrongfully. If wrongfully pledged then petitioner's stocks should be sold first, because he consented to the pledge of his stocks; if the margin stocks are deemed to have been *rightfully* pledged i. e., with their owner's consent, (we may say in passing that there was no proof of any such consent) then a case is presented where all of the stocks were in the pledge with their owners' consent.

No matter which way we look at the situation petitioner must contribute his share.

If the stocks of the other customers were wrongfully in the pledge then their equities are superior to those of the petitioner because he consented to the pledge of his stocks and "he who consents to an act is not wronged by it" (Civ. Code, 3515) while if, on the other hand, the stocks of said other customers were rightfully in the pledge then *all* of the pledged stocks were *equally situated* and should receive equal treatment.

APPELLEE'S AUTHORITIES.

Appellee cited in the court below several decisions, among them being,—

Re Wilson, 252 Fed., 631;

Re McIntyre, 181 Fed., 955 (C. C. A.).

In the Wilson case the court stated the rule to be that "the extent of the wrong is the measure of the equity" (p. 650) and on the same page laid down the following rule:

> "As between securities hypothecated with authority and those hypothecated without authority, obviously the latter have the superior equity."

According to the above excerpt the equities of the other customers of Mason & Owen are superior to those of appellee because the latter's stock was hypothecated *with his authority*, and ought to be sold and the proceeds *entirely* exhausted before recourse is had to the stocks hypothecated without authority.

The other case cited by appellee and usually referred to as Pippey's case is not applicable to the case at bar because the stock there in question had been hypothecated *without* the owner's consent, and the court specifically stated that the hypothecation of Pippey's stock "was a *larceny* of his stock." (p. 958.)

The opinion in Pippey's case cites *Tompkins* vs. *Morton Trust Co.*, 86 N. Y. Supp., 520, but it is to be noted that the court in that case placed its decision on the same ground as the opinion in Pippey's case, viz., that the "use of this stock as collateral security for a loan was a *larceny* of the stock." (See p. 523 of opinion.)

The other decision cited in Pippey's case was *Kavanaugh* vs. *McIntyre*, 112 N. Y. Supp., 987, and the court said, "In short, the acts disclosed constituted *larceny*." (p. 992.)

We do not see how it can be contended that the above cases are precedents for the case at bar. In those cases the stockbroker had committed *larceny*. The stock, when located, was merely *stolen* property, which can always be reclaimed by its owner, but in the case at bar the stockbroker had been given specific authority to

hypothecate it. Certainly Mason & Owen could not be convicted of *larceny* for doing what appellee agreed they could do, *i. e.*, pledge his stock.

The cases cited by appellee in the court below can be distinguished from the case at bar by the fact that the claimant in those cases had not authorized the hypothecation of his stock while in the instant case the claimant had given authority to pledge.

AMOUNT OF CONTRIBUTION.

If Your Honors hold that petitioner's equity under the facts of this case is inferior to the equity of the other customers, then his stocks must be sold and the proceeds entirely exhausted before recourse is had to the other stocks.

If, however, it is held that the equities of said other customers are not superior to those of petitioner and that *all* of the stocks were rightfully in the pledge, then petitioner should simply stand his *pro rata* share of the common burden of the Logan & Bryan loan.

On the latter theory his share would be such proportion of the whole indebtedness as the value of his stocks bore to the value of *all* the stocks.

His stocks were worth $3,375.00, (Record, p. 17). All of the stocks were worth $339,156.00, (Record, p. 8), and the indebtedness was $208,338.09, (Record, p. 17). His contribution would therefore be such proportion of $208,338.09 as $3,375.00 bears to $339,156.00, or $2,083.38, plus interest at the rate of 7% per annum from the date when he should have made his contribution, i. e., the date of sale, December 8, 1920.

We therefore ask either that the claimant's petition be dismissed on the ground that his stocks should be held primarily responsible for the *entire* indebtedness, or that he be required to contribute his *proportion* of the indebtedness on the theory that "he who asks equity must do equity".

Respectfully submitted,

WILL J. THAYER,
Appellant's Attorney.